

COMMENTS ON ISSUES SET OUT IN THE CONSULTATIVE DOCUMENT ON CLARIFYING AND REFORMULATING THE DIRECTORS' ROLE AND DUTIES

Response to Consultation Questions:-

Question 1:

Do you agree that the definition of the word 'director' should be amended to be stated as follows:-

'any person occupying the position of a director of a corporation by whatever name called and includes a person in accordance with whose direction or instructions the majority of the board of directors of a corporation is accustomed to act'?

YES. We agree with CLRC's recommendation.

Question 2:

Do you agree that section 129 of the Companies Act 1965 should not be retained whereby there should be no statutory maximum age-limit for a person to be appointed as a director?

YES. This should be left for the discretion of the Board and shareholders to decide. In practice, at the AGMs approval is almost always given. What is important is for management of company to deal with such a Director as they have all information necessary to decide the fitness of the individual to be appointed as a director.

Age alone does not automatically mean a person can no longer perform well as a company director. Similarly, youth does not guarantee better mental capacity or performance. A company would be best served by a Board which has a balanced composition, both in terms of knowledge and wisdom.

Question 3:

Do you agree that the Companies Act 1965 should clarify that a director must not be less than 18 years of age?

YES and preferably to follow the Age of Majority Act (1971) now in force. The Companies Act can follow when the former Act reviews the age limit (upwards or downwards).

Question 4:

Do you agree that the residency requirement imposed on directors should be retained?

YES, for practical purposes. It is better to have minimum of 2 directors resident in the country. In case of need, if one is not traceable, parties would still have a chance to contact the other director to resolve certain matters.

Question 5:

Do you agree that the appointment of directors of a public company must be voted on individually?

YES. Perhaps do away with the no objection provision as it tends to negate the intention that each director must be treated separately. In practice, the Chairman in most cases for the sake of saving time, persuades members at the AGM to vote enbloc. At times, a shareholder pushes the issue. Time constraints should never be a reason for bundling the voting exercise. Furthermore, shareholders may be supportive of one (or several) candidates by not necessarily all. If they are grouped to be voted enbloc, shareholders are forced to decide on all altogether. If they do not vote at all, their preferred candidates do not get voted on at all too.

We agree that Directors should be appointed by company – invariably initiated by larger shareholders or by Chairman/ Managing Director to allow for business exigencies consideration – as in any case directors are subjected to voting at AGMs soon enough.

We would, however, like to suggest that the letter of notification of appointment of a director should contain clear statement of duties, terms and conditions of fees/ remuneration etc. (for all executive and non-executive directors) and such letter to be duly acknowledged and signed by the director. This letter may also be filed in the register of directors.

Prospective directors are strongly advised to know and understand their responsibilities and obligations, paying particular attention to the Articles, adoption of a Director's Service Contract and take proper professional advice. This is important in director training programme.

Question 6:

Do you agree that section 128 of the Companies Act 1965 which provides for the right of members of a public company to remove its directors should be retained and that the section should not be extended to private companies?

YES. We agree that section 128 should be retained.

We are also of the view that section 128 should be extended to private companies too. This is to protect other stakeholders and the minority shareholders of the private companies.

Directors in all types of companies have common basic responsibilities and duties. Even if there are only 2 directors (who may also be the only shareholders) they owe responsibility to:-

- (a) each other as directors and shareholders;
- (b) to the company which is a corporate soul; and
- (c) to the company's stakeholders (external and internal)

Question 7:

If yes, do you agree that the requirement to serve special notice in relation to the director's removal should be applicable if the removal is made under the section only?

YES. We agree with CLRC's recommendation.

Question 8:

Do you agree that the Companies Act should incorporate a provision that will enable a person who has resigned as a director to give a notice of his resignation to the Regulators in the event the company does not do so?

YES. We agree that the director be given the right to lodge notice of resignation with the Regulators, i.e. Companies Commission of Malaysia (CCM). This adds authenticity to his resignation and also aids the authorities (CCM and bankruptcy department) to track companies that do not file the appropriate forms to report the director's resignation (and date thereto). This also helps to determine the cut-off date for his responsibility on the Board's decisions and actions after his resignation.

Regarding the effective date, this should be clearly worded such that only if the effective date is not stipulated in the letter, would the date of acceptance of the letter by CCM be the effective date.

Giving of notice should be allowed not only in the event the company does not act accordingly, it should be allowed in any event.

Question 9:

Do you agree that the Companies Act should incorporate a provision that requires directors' remuneration to be approved by shareholders at the general meeting?

Whilst we agree that this is the right direction to take, we have the following concerns:-

1. Do we differentiate between Executive and Non-Executive Directors?
2. "Remuneration" requires clear definition. The term "remuneration" to include salary? Is the term "emoluments" the same as "remuneration"?
3. Do we want to allow access to the contract of employment of each director to all members of the company?

Question 10:

Do you agree that the Companies Act should incorporate a provision that will provide company members with a statutory right to inspect its directors' contracts of service?

YES. This is good for transparency and accountability. It does ensure that the Board as a whole would not risk being queried publicly of being incompetent if the terms of the director's contract of services are not in the interest of the company and shareholders.

Such contracts should be signed, sealed and effected preferably after the shareholders' approval.

Question 11:

Do you agree that interested directors or their agents or trustees should be prohibited from voting in the meeting which is convened to approve the proposed payments made to the directors pursuant to section 137?

YES. We agree with CLRC's recommendation.

Question 12:

Do you agree that where a subsidiary is going to make a payment to its director (whether or not that director is also a director of its holding company) pursuant to section 137, that payment must be approved by the shareholders of the holding company in addition to the shareholders of the subsidiary company?

YES. The amount to be paid should not be a matter for consideration. It can be insignificant, but approval should be secured regardless.

Question 13:

Do you agree that the Companies Act should provide that the board of directors' role and function is to manage the affairs of the company?

1. YES. Directors' duties should be set out in a statute but at a high level of generality, capturing the essential principles, and not in the form of detailed behavioural rules.
2. A consequential effect is perhaps to promote an annual Operating and Financial Review (OFR) to be made mandatory.
3. The law should not reinforce short-termist attitudes but rather make clear that director's obligation is to take a balanced view consistent with maximizing overall economic performance. In doing so, they have the explicit duty to take responsibility for the company's relationships and broader impacts and for protecting its reputation.
4. The core obligation should always be to promote the success of the company for the benefit of the shareholders subject to compliance with the company's constitution and the duty to act for a proper purpose.
5. The Health and Safety at work should be emphasized, embodying statutory obligations of increasing significance to directors.

The standard expected of directors is much higher now. Directors are now expected to be able to read and understand accounts, attend meetings as scheduled regularly to appraise themselves of the affairs of the company.

Question 14:

Do you agree that the reformulation of a directors' standard of care and skill should be as follows:

'Duty to exercise reasonable care, skill and diligence

- (1) A director of a company must exercise reasonable care, skill and diligence.**
- (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with-**
 - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and**
 - (b) the general knowledge, skill and experience that the director has'?**

YES. This is an adoption of the UK Company Law Reform Bill 2005. This does seem to be the right direction to take as the scope of the hybrid test covers both tradition and realities. However, the Companies Act does not lay down any minimum standard of competency. Therefore, the present test to judge competency or the standard of a reasonable director is governed by common law. This may lead to absurd situations where a company's affairs are badly managed and yet its directors are able to avoid personal liability by proving that they honestly believe that their actions are beneficial to the company. To avoid this scenario, the law ought to impose a more objective standard on directors' duties pertaining to their standard of care and skill. In effect, the test of the degree of care exercisable by directors is stricter and objective one.

Competent directors are needed to ensure that shareholder value is maximized by being able to provide direction to the company as well as monitoring the performance of management.

Question 15:

Do you agree that the Companies Act should incorporate an express provision that:

- (a) enables company directors to rely on information provided by the company's employees, professional advisers or by another director or by a directors' committee; and**
- (b) that reliance by a director on that information should be made in good faith and only where the director has made proper inquiry of that information before relying on that information, if the need for inquiry is warranted by the circumstances? And**
- (c) that a director shall not rely on the information provided for by the delegate if the director has knowledge that the information is unreliable?**

YES. This is a relevant and significant amendment as indirectly it upgrades Directors' professionalism. If adopted, these provisions should also be incorporated in the letter of notification of appointment as director of the company.

Some points to consider:-

- (i) Do directors have full and unimpeded access to all information and the company's records?
- (ii) Can all reasonable requests for information be complied with unless complying with such request would be detrimental to the company?
- (iii) If management refuses to comply with a request for information, can the Chairman or the CEO provide a written justification to the Board?

Nevertheless, while a director may at times have to make decisions based on information provided by other sources, he cannot accept them per se without seeking to satisfy himself on the quality of that information. He cannot later use that as an excuse for a failed decision. He can only fall back on the defence as envisaged here if the information is later determined to be totally unreliable, false, bad or tainted with the producer's ulterior motives.

Question 16:

Do you agree that the Companies Act should incorporate an express provision stating that:

- (a) company directors may delegate any of their powers to a committee of directors, a director, an employee or any other person? And**
- (b) the delegate must exercise his power in accordance with any of the directions laid down by the directors?**

YES. It is consequential to Question 15 and should also be expressly provided in the Act. Item 16 (a) is a consequential item to be included in the proposed director's letter of appointment. For item 16 (b), suffices to be in the Act.

The Directors as a Board (or individually) may delegate their powers with appropriate instructions, terms of reference and limits of authority. These directions should be clear and precise to avoid blame reverting to the Directors (or a Director) should problems arise following the delegate's actions.

Just how far can directors go in delegating their duties without breaching an equitable duty to exercise a reasonable degree of care and skill is a vital one for all directors and their advisors.

Question 17:

Do you agree that the exercise of power by a delegate in the above circumstance is to be treated as if the directors have exercised that power?

YES. In the case of an Alternate Director, the latter has to be responsible for his actions (if he had not been given specific directions by his principal director).

This is an important issue pertaining to the duties of directors involved in a group of companies especially where solvency and related matters are concerned.

Question 18:

Do you agree that the director will not be liable for the acts of the delegate if that director can satisfy the following two conditions:

- (i) that at all times the director believed on reasonable grounds, that the delegate would exercise his power in conformity with the duties imposed on directors by the Corporations Act and the company's Constitution; and**
- (j) that the company director believed on reasonable grounds, in good faith and after making proper inquiry, if the circumstances warrant an inquiry, that the delegate was reliable and competent in relation to the power delegated to him.**

YES. This is a necessary defence and consistent with the duty expressed in Question 14.

While there may be room for requiring people below the board level to face some responsibility for their actions, it is also important that the blame for failure is not simply passed down the chain and that the overall duties imposed by the Companies Act are not diluted.

Question 18:

Do you agree to the introduction of the business judgement rule in the Companies Act?

YES. We agree that the Act provides for business judgement rule (BJR) but, what, how and when applicable needs further discussion. A business judgement can be very subjective and would be dependent on wide ranging and varying terms, which can be fluid and dynamic. The BJR needs to be expressly worded so as to be fair and logical.

Recent articles on BJR seem to state:-

- (i) there is confusion in the nature of the rule
- (ii) that the rule should not be applied for benefit of director's protection at the expense of the company's and shareholders' interests
- (iii) case laws so far favoured protection of directors if there is no breach of duty even if company suffers
- (iv) there is a need to move towards "Abstention Doctrine" to save litigation expense amongst other things

Some points to consider on 'business judgement':-

- (i) can business judgement mean any decision to take or not take action in respect of a matter relevant to the business operations of the corporation?
- (ii) can a business judgement be suffice to meet the requirements of directors' duties at common law and in equity?
- (iii) for a business judgement made in good faith taking into consideration the material personal interest in the subject matter of the judgement, do directors have to reasonably and rationally believe that the judgement is in the best interest of the company?

Directors' belief that the judgement is in the best interest of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

The proposed merger of Sime Darby, Guthrie and Golden Hope could be an interesting study!

Question 19:

Do you agree that the relationship between a company and its creditors and employees should not be regulated under the Companies Act 1965?

YES. We agree with CLRC's recommendation.

However, issues covering Corporate Social Responsibility do need to be considered for incorporation into the Act.

There is also the whole area of enforcement (duties are illusory if not enforceable!) and the whole area of corresponding remedies for injured shareholders (are they sufficient and clear?).

There is a growing trend towards the recognition of a duty which is owed by directors of a company to the creditors and employees, particularly in circumstances where the company is insolvent or in a state of near insolvency. This trend has particular significance as seen in the recent Asian financial crisis and should be appreciated by directors, creditors and employees alike.

In appropriate circumstances, directors could find themselves liable in damages to creditors or employees for a failure to take reasonable care e.g. wrongful trading, health and safety at work.

Question 20:

Do you agree that the term 'honestly' appearing in section 132(1) should be replaced with an express statement requiring directors to act in the best interest of the company and to use their powers for a proper purpose?

YES. We agree with the CLRC's recommendation.

Case law has determined a director must act bona fide in what he considers as in the best interest of the company, not what a court may consider. It is up to the directors in the exercise of their business judgement to decide how the interests of the company can be best promoted.

Question 21:

Do you agree that the express inclusion of the phrase 'to act in the best interest of the company' into section 132(1) should not be statutorily clarified and hence what is in fact 'the interest of the company' should be left to judicial decision to develop?

YES. We agree with the CLRC's recommendation.

Question 22:

Do you agree that the Companies Act should incorporate a provision which sets out the common law conflict of interest situations (as stated above) to be avoided by a company director?

YES. We agree with the CLRC's recommendation.

Professionals who serve on the board of company including lawyers, accountants and others, provide and undertake professional work to the company they serve on the board. In such a case, often directors who undertake work in the company they serve on the board could place management staff of the company in an awkward position when they have to question such directors in respect of the advice rendered to the company.

Directors will also have conflicting or cross directorships or another directorship in the same industry. In those circumstances, the most appropriate action is to ensure that full and frank disclosure has been made. It is essential that directors be made fully aware of their fiduciary duties as directors.

Question 23:

Do you agree that the Companies Act should include a provision that a company director will not be held liable if there is approval or ratification of the conflict of interest by the appropriate organ of the company i.e. the shareholders at the general meeting?

YES. Perhaps a sub-clause can be added stipulating that approval is deemed invalid in the absence of a full and frank disclosure.

It is also preferable that the law governing the holding company/ subsidiary relationship be clarified further in the Companies Act. Directors of subsidiaries may feel obliged to agree to the directors of the holding company because subsidiaries' directors are usually nominated by the holding company.

Question 24:

Do you agree to the strict approach which provides that the company legislation should incorporate a provision that clearly states that the primary duty of a director (even if he is a nominee director) is to act in the interest of the company that he has been appointed to?

YES. This is a basic tenet of corporate directorship. Current regime recognizes that there is no distinction between executive directors, non-executive directors, nominee directors; under the law they are all "directors", subjected to ensuring that they act in the best interest of the company.

Nevertheless, nominee of a substantial shareholder may be put in a spot with tough decision which had not been envisaged earlier. He may even feel he needs to discuss and get guidance from his principals because apart from a difficult business decision, it could also be an issue which is detrimental to his principal. The Board of Directors could be more discerning and defer decision and allow that Director time grace.

Question 25:

What are your views in allowing for the adjusted duty in relation to nominee directors, in respect of –

- (a) a wholly-owned subsidiary only?**
- (b) companies within a corporate group structure as long as there is a holding-subsidiary relationship?**
- (c) a joint-venture company?**

We agree to adjusted duty in relation to nominee directors in respect of a wholly-owned subsidiary only.

We do not agree to adjusted duty in relation to nominee directors in respect of companies within a corporate group structure and/or a joint-venture company where protection of minority interests will be required.

Question 26:

Do you agree that the effect of section 140(1) that 'a provision, whether in a contract with the company or in the company's Articles that provides for exempting directors from any liability is void' should be preserved?

YES. We agree with CLRC's recommendation.

Question 27:

Do you agree that a company may be allowed to provide indemnity for any costs of defending legal proceedings, whether civil or criminal, only when the director is successful (whether by a judgement in his favour, an acquittal or by a discontinuance)?

YES. We agree with CLRC's recommendation. However, full and frank disclosure of the indemnity and costs is absolutely necessary for shareholders to assess and evaluate.

Question 28:

Do you agree that a company may be allowed to provide indemnity for the costs of a successful claim to the court for relief from liability?

YES. We agree with CLRC's recommendation. However, full and frank disclosure is absolutely necessary.

Question 29:

Do you agree that section 140 should be clarified to provide that the company may indemnify its officer or auditor for costs and expenses incurred by that officer or auditor in defending an action commenced by a third party (the third party being a person other than the company)?

YES. We agree with CLRC's recommendation. However, full and frank disclosure is absolutely necessary.

Question 31:

Do you agree that a company should not be allowed to purchase or maintain insurance for its officers in relation to the liability owed towards the company? If yes, do you agree that the prohibition be extended for liability towards a related company?

YES. We agree that a company should not be allowed to purchase insurance for its officers in relation to liability owed towards the company and this prohibition should also be extended for liability towards related companies.

Question 32:

Do you agree that section 140 should be clarified to allow a company to purchase or maintain insurance or to indemnify its officer or auditor for costs, expenses and liability incurred by that officer or auditor in defending an action commenced by a third party (the third party being a person other than the company)?

YES. We agree with CLRC's recommendation. However, full and frank disclosure is absolutely necessary. Adherence to arm's length procedures need to be followed.

Question 33:

Do you agree that any insurance or indemnification will have to be disclosed to the shareholders? If yes, should the disclosure be made in the directors' report?

YES. Shareholders should know what their Directors are being indemnified against. Full and frank disclosure is absolutely necessary.